MERGER AND ACQUISITION CONTROL: CONFORMING PROCEDURES TO ICN RECOMMENDATIONS

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It is a pleasure for me to be back in Beijing to appear before this International Symposium on Competition Policy and Legislation. I am grateful to the State Administration for Industry and Commerce, the Asian Development Bank, and the Organisation for Economic Cooperation and Development for inviting us to participate. Together with my colleagues in the United States delegation, I welcome the opportunity to share our experience with you, particularly at this important time in the development of Anti-Monopoly Law in China. We appreciate the effort that the Chinese government and expert groups are devoting to ensure that the legislation will be based on sound principles and practices aimed at contributing to the growth of the economy and the welfare of the public. We hope that our comments and experience will assist in this process.

Last month I had the honor to participate in the International Symposium on the Draft Anti-Monopoly Law of the People's Republic of China, held in Beijing under the sponsorship of the Legislative Affairs Office of the State Council, together with the State Administration for Industry and Commerce and the Ministry of Commerce. My remarks there addressed three topics – abuse of dominant position, merger control, and agency structure.[1] My objective here is to expand on the discussion of merger control, with a particular focus on merger review procedures.

In particular, my presentation last month briefly identified the important work of the International Competition Network (the "ICN") in developing Recommended

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* The views expressed in this presentation are those of the author and do not necessarily represent the views of the Federal Trade Commission or of any individual Commissioner.

[1] *See* William Blumenthal, *Presentation to the International Symposium on the Draft Anti-Monopoly Law of the People's Republic of China* (May 23-24, 2005), *available at* http://www.ftc.gov/speeches/blumenthal/20050523SCLAOFinal.pdf.

Practices for Merger Notification and Review Procedures. Today I would like to examine the ICN's work in greater detail, with a focus on the Recommended Practices most relevant to the merger notification provisions that China is planning to include in the Anti-Monopoly legislation.

An important starting point in assessing merger review procedures, and merger review more generally, is that the vast majority of merger transactions do not raise competitive concerns. To the contrary, individual mergers are often pro-competitive and efficiency-enhancing. From the perspective of an economic system as a whole, the availability of mergers as a mechanism in the capital markets encourages investment by providing entrepreneurs and investors with a means for recovering their funds and potentially earning a return.[2] As enforcers of competition law, we have a special responsibility to promote efficient merger review procedures to ensure that the public reaps these merger benefits. Merger review regimes that impose excessive transaction costs and unduly burden the parties with unnecessary information requirements or lengthy timetables can have unfortunate and unintended consequences –discouraging mergers and investment, inhibiting efficiencies, and taxing enforcement agency resources, all without corresponding benefit to competition.

More than seventy jurisdictions around the globe now have some form of merger review. While merger review has the potential to benefit each of these jurisdictions, care must be taken to assure that the cumulative effect on multi-jurisdictional transactions does not result in the imposition of excessive costs and burdens on the merging parties. Both this objective and the separate objective of efficient use of enforcement agency resources are enhanced by effective coordination among reviewing agencies.

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[2] For one recognition of this consideration, see *Pillsbury Co.*, 93 F.T.C. 966, 1041 (1979), where the Commission (quoting Philip Areeda, Antitrust Analysis ¶ 617(h), at 690 (2d ed. 1974)) wrote:

> Long-term competitive considerations require preservation of ease of entry, and opportunity for businessmen to take entrepreneurial risks. The other side of that coin is a largely unarticulated policy, a clear corollary to the first, which would preserve exit opportunities where significant anticompetitive results do not occur. It is essential that the owners of very small businesses with slight competitive potential have some reasonable flexibility to sell out. This set of considerations is particularly compelling where the small acquired asset is a family-owned business which has come upon uncertain and perhaps adverse business conditions. Professor Areeda summarized relevant factors that attend that situation in the following terms:
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> "The retiring entrepreneur may lack confidence in his successors or may prefer the security of portfolio diversification. Or a firm may be impelled toward merger by the fact or fear of relative decline. The actual or prospective difficulties might be in management, research, marketing, capital, labor, or anything else that affects a firm's fortune. Sale of the company as a going business may cause minimum disruption to owners, managers, suppliers, customers, employees, and communities. To facilitate exit when it is desired may indeed facilitate entry. The likelihood of exit with minimum loss or maximum gain increases the attractiveness and reduces the risk of entering a market."

These issues were among the first to be addressed by the ICN, the membership in which now numbers 88 competition agencies from 78 jurisdictions. Upon founding the ICN in 2001, the member agencies established a Mergers Working Group to address the challenges of merger review in a multi-jurisdictional context. The Working Group's output includes a set of Recommended Practices for Merger Notification Procedures,[3] representing international best practice for the development of merger notification procedures. As their title suggests, these are not legally binding requirements, but rather recommendations for competition agencies to consider, and they have. As of April 2005, 46% of ICN members with merger laws have made or proposed changes that bring their merger regimes into closer conformity with the Recommended Practices, and an additional 8% are considering such changes. The ICN also invites non-members to rely on these materials.

In today's presentation I will focus on four of the key Recommended Practices that have applicability to Chapter 4 (Control of Concentrations) of the draft Anti-Monopoly Law – jurisdictional nexus, notification thresholds, timing of review, and requirements for initial notification. I will then discuss several important procedural elements that are not specifically addressed in the draft Law, but that are included in the Recommended Practices and are likely to be covered eventually in China through implementing rules, regulations, guidelines, or agency practices.

NEXUS TO THE REVIEWING JURISDICTION

The ICN's first Recommended Practice (Nexus to Reviewing Jurisdiction) provides that each jurisdiction's merger review rules should seek to screen out transactions that do not have an appreciable effect on competition within the jurisdiction. Merger control should cover only transactions that have an "appropriate nexus with the jurisdiction concerned." The rationale: Requiring notification of transactions that do not meet an appropriate standard of materiality as to the level of "local nexus" imposes unnecessary transaction costs on parties and consumes agency resources without any corresponding enforcement benefit. Accordingly, the Practice provides that notification of a transaction should not be required unless the transaction is likely to have a significant, direct, and immediate economic effect in the jurisdiction concerned.

Experience demonstrates that thresholds based on significant local sales or asset levels within the territory of the jurisdiction concerned are most suitable, and the Recommended Practice identifies these two factors as appropriate determinants of materiality. The Recommended Practice is silent as to the appropriate level at which to set such thresholds, because this will differ by jurisdiction. In the United States, for a transaction between foreign entities to be notifiable under our Hart-Scott-Rodino premerger notification filing requirement, the parties must have combined U.S. sales or assets exceeding US $110 million, and the acquired party must have assets or sales in or into the U.S. exceeding US $50 million. The EU, by contrast, uses a higher primary

[3] The Recommended Practices are available on the Internet at http://www.internationalcompetitionnetwork.org/notification.html.

threshold (each of at least two parties must have EU sales exceeding Euro 250 million), in part because its system is designed to channel smaller transactions to Member States.

These examples highlight another key component of the ICN's jurisdictional nexus Practice: they measure nexus by reference to the activities of at least two parties to the transaction in the local territory and/or by reference to the activities of the acquired business in the local territory. The Recommended Practice notes that many jurisdictions require significant local activities by each of at least two parties to the transaction before the nexus requirement is satisfied; this is viewed as an appropriate local nexus screen.

With respect to transactions involving only one party with appropriate nexus to the jurisdiction, the Recommended Practice observes that the risk of competitive harm is sufficiently remote that the burden associated with notification is normally not warranted. The Recommended Practice further provides that if local nexus requirements are to be based on a single party, the requirements should (i) focus on the activities of the acquired business and (ii) use thresholds that are sufficiently high to avoid notification of transactions without potential material effect on the local economy.

The Recommended Practice states that notification should not be required solely by reference to the acquiring firm's local activities – for example, by reference to a local sales or assets test that can be satisfied by the acquiring person alone. Otherwise, notification would be likely to impose unnecessary transaction costs on a large number of transactions that do not pose any appreciable risk of competitive harm in the jurisdiction. The Recommended Practices include a narrow exception (I.C comment 4) that was crafted to protect special situations in small economies, but the exception does not appear to be applicable to China.

NOTIFICATION THRESHOLDS

With the burgeoning number of merger notification regimes worldwide, it is critical that each jurisdiction employ notification thresholds that are clear, understandable, and based on objectively quantifiable criteria. The ICN's second Recommended Practice (Notification Thresholds) notes that the efficient operation of capital markets is best served by such bright-line tests, which are more are easily administrable by both agencies and parties.

The Recommended Practice identifies assets and sales as its two examples of objectively quantifiable notification criteria. All major jurisdictions with mandatory premerger notification currently conform to the recommendation or have made significant efforts to change their systems so as to conform.

The Recommended Practice explicitly states that thresholds based on market shares are inappropriate at the notification stage because they are not objectively quantifiable. Market share thresholds are extremely difficult for both the parties and the agencies to apply. They require significant amounts of data in order to define the

relevant market, determine its overall size, and calculate the percentage attributable to each competitor. Market share determinations may be appropriate at a later, more substantive stage of the merger review, but our experience and the Recommended Practice dictate that they should be avoided for purposes of merger notification thresholds.

Similarly, a threshold requirement based on the portion of the value of a transaction attributable to the jurisdiction is too subjective or arbitrary to be an appropriate notification requirement. In the context of a multi-jurisdictional transaction, the parties generally will not have made such allocations prior to the time at which they must determine where to file notification. If such allocations are eventually needed for commercial reasons, they will require complex modeling and often tax and accounting judgments that cannot reasonably be expected at the notification stage.

REVIEW PERIODS

With the increasingly frequent experience of numerous jurisdictions reviewing the same transaction, the ICN's fourth Recommended Practice (Review Periods) recognizes the importance of review timetables based on reasonable, yet flexible periods. The Recommended Practice reflects parallel judgments: (a) that capital markets and related business interests are better served by avoiding unnecessary delays to closing and (b) that more effective enforcement is better served by facilitating the opportunity for agencies reviewing the same transaction to coordinate their activities.

The Recommended Practice starts with recognitions that mergers may present difficult legal and economic issues and that agencies require sufficient time to properly investigate a transaction. It continues, however, by acknowledging that the vast majority of notified transactions do not raise material competitive concerns, and it states that merger review systems should be designed to permit such transactions to proceed quickly. Mergers are time sensitive, and delay in clearance presents numerous commercial risks – adversely affecting the ongoing operations of the parties due to uncertainty among customers, employees, and suppliers; postponing the attainment of efficiencies that the merger will yield; and in the extreme case jeopardizing the entire transaction.

Many jurisdictions around the globe have adopted a two-phase review system to allow non-problematic transactions to proceed expeditiously following a preliminary review. The Recommended Practice cites this approach as appropriate.

With respect to review timetables, the Recommended Practice provides specific detail: initial waiting periods should expire in six weeks or less from notification. Many jurisdictions, including the U.S., require completion of initial reviews within 30 days of notification. The Recommended Practice also provides that Phase II, or extended reviews, should be completed or capable of completion within six months or less following initial notification.

Extension of the review period beyond these targets will generally be viewed as problematic. The Recommended Practice recognizes that a six-month waiting period may be insufficient in some instances, and it notes that procedures should be sufficiently flexible to allow for limited extension with the consent of notifying parties, but the Practice limits the applicability of such a possible extension to narrow circumstances. Factors such as document verification and change in circumstances go beyond those recognized in the Practice.

The Recommended Practice also relies on flexibility in other areas. In particular, it provides that each jurisdiction's procedures should enable the competition agency to grant early termination of applicable waiting periods, once the agency determines that the proposed transaction does not raise material competitive concerns.[4] This flexibility can be important to merging parties to guard against the deterioration of assets and to ensure that the merger's benefits are realized without undue delay or burden.

REQUIREMENTS FOR INITIAL NOTIFICATION

Flexibility is also important with respect to requirements for initial notification. The ICN's fifth Recommended Practice (Requirements for Initial Notification) recognizes that the duty to notify applies to transactions covering a wide range of possible competitive effects and that no single set of initial notification requirements will be optimal for all transactions. The Practice states, however, that because most transactions do not raise material competitive concerns, the initial notification should elicit the minimum amount of information necessary to initiate the merger review process by verifying that the transaction exceeds jurisdictional thresholds and determining whether the transaction raises competitive issues meriting further investigation.

The amount of information required will vary depending on the approach to notification thresholds taken by the jurisdiction. The Recommended Practice cautions jurisdictions that review a large number of transactions (due to low jurisdictional thresholds) to be particularly sensitive to disproportionate burdens arising from the breadth of their initial filing requirements. The United States, which receives between 1000 and 5000 notifications annually,[5] has a very simple notification form. Even if limited to a small number of transactions, information requirements that reach details of production costs and prices of non-overlapping products appear to go beyond the Practice's accepted scope.

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[4] In the United States, for example, roughly two-thirds of transactions receive early termination of the waiting period. *See* Federal Trade Commission & U.S. Department of Justice, *Twenty-Sixth Annual Report to Congress Pursuant to Section 201 of the Hart-Scott-Rodino Antitrust Improvements Act of 1976* app. A (Sept. 7, 2004). Early termination is often granted in as little as two weeks.

[5] *See id*. The largest number was 4,926 in US fiscal year 2000. The notification thresholds were raised substantially the following year, and the number of notifications therefore has been reduced.

To enable the agency to accomplish its mission without imposing unnecessary burdens on merging parties, the Recommended Practice provides that jurisdictions should adopt mechanisms that allow for flexibility in the content of the initial notification and/or with respect to additional requirements during the initial phase of review. Some countries, such as the US, have a simple, abbreviated initial notification form, but may request additional information during the initial review period to determine whether the transaction presents materials concerns. Other jurisdictions, such as the EU, require more extensive initial notification requirements, but afford agency staff the discretion to waive information requirements that are not sufficiently relevant to the agency's disposition of the transaction. Still other countries, such as Canada, provide parties with an option of long and short form notifications, with long forms filed only in cases giving rise to competition concerns. Flexibility of this type has proven to be valuable in averting significant burdens both for parties (with respect to the time and cost of compiling such information for transactions that do not raise competitive concerns) and for enforcers (with respect to the need to devote resources sorting through information unnecessarily compelled from the parties).

OTHER CONSIDERATIONS

The various ICN Recommended Practices address other procedural matters that might not be included in an implementing law, but that are important for the effective operation of a merger review system. Implementing laws generally identify and establish a regime's key elements, but leave additional detail to be addressed by subsequent rules, regulations, and agency guidance or practice. The Recommended Practices can be useful to agencies responsible for merger review with respect to such implementation issues.

One example is translation and authentication, which are addressed in Recommended Practice V.D. As to translation, the Recommended Practice provides that an agency may appropriately require notification in an official language, but it may choose to accept additional languages, and it should not require extensive translation of supporting documents, such as transaction agreements and annual reports submitted as part of the notification. The Practice also notes the utility of translated summaries and excerpts.

A second example is timing of notification, which is addressed in the ICN's third Recommended Practice (Timing of Notification). This Practice provides that parties should be permitted to notify proposed mergers upon a certification of a good faith intent to consummate the proposed transaction and that a jurisdiction that prohibits closing for a specified time following notification should not impose deadlines for pre-merger notification. The EU modified its practices last year to conform to the Practice.[6]

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[6] As the EU explained:

> Will parties be able to come earlier to the Commission for approval of a planned transaction?

Providing this flexibility allows parties to make filings efficiently and can facilitate coordination of multi-jurisdictional filings and the coordinated review of such filings by agencies.

The ICN's sixth Recommended Practice (Conduct of Merger Investigations) is helpful to both experienced and new agencies in identifying essential factors to consider with respect to investigations. This Practice highlights the importance of a frank and open dialogue between the agency and merging parties, and it explains how and why merger investigation procedures should include opportunities for meetings or discussions between the competition agency and the merging parties at key points in the investigation. It also suggests approaches for the agency to consider in order to avoid imposing unnecessary or unreasonable costs and burdens on merging and third parties in connection with merger investigations. Finally, it identifies the importance of transparency, confidentiality, and procedural fairness as part of any merger review system. These three elements are considered so important that they are also addressed individually in dedicated Recommended Practices – the seventh (Procedural Fairness), the eighth (Transparency), and the ninth (Confidentiality).

Finally, throughout the Recommended Practices and in a dedicated tenth Recommended Practice (Interagency Coordination), the ICN addresses the benefits of interagency coordination for merger reviews that may raise competitive issues of common concern. The dedicated (tenth) Practice notes that coordination can foster effective, consistent outcomes in the coordinating jurisdictions and reduce unnecessary burdens for parties and agencies, and provides guidance to agencies on how to effectively coordinate their reviews. It is important to assure that implementing laws give the enforcement agency adequate authority and responsibility to coordinate with its foreign counterparts, subject to appropriate confidentiality protections and other procedural mechanisms.

A NOTE ON SUBSTANTIVE STANDARDS

My presentation this afternoon has focused on the procedures for merger notification, rather than the substantive standards governing merger review. The emphasis warrants a word of explanation. Substantive standards normally precede

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> Yes. Notification is now possible on the basis of good-faith intent to merger, where previously a binding agreement was required. This gives greater flexibility to businesses as regards when to seek regulatory clearance.
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> And how about the seven-day deadline for the filing of a notification?
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> In view of the bar on closing, it was concluded that this amounted to an unnecessary regulatory rigidity and so it has been abolished.

European Commission, DG Competition, *Merger control: Merger review package in a nutshell* (Jan. 20, 2004), at 2 (available at http://europa.eu.int/comm/competition/index_en.html (click Policy Areas: Mergers: Overview)).

procedures, since the specification of particular procedures ordinarily will depend crucially on the substantive standards that they are intended to implement. I have reversed the focus here largely in recognition of the practicalities of global merger review.

The four elements on which this presentation has focused – jurisdictional nexus, notification thresholds, timing of review, and requirements for initial notification – directly affect literally thousands of transactions every year. Most merger review regimes provide for extraterritorial application, and even mergers between two foreign companies are subject to local notification obligations if the parties satisfy the regime's nexus requirements. As a result, thousands of times each year, at least for transactions involving sophisticated legal or banking advisors, someone somewhere works through a checklist comparing the parties' financial records and business activities against the jurisdictional tests for the world's merger review regimes, now more than seventy in number and growing. To the extent those tests involve anything beyond the most basic facts and legal judgments, they collectively impose substantial costs and delays. Small burdens multiplied by many jurisdictions multiplied by many transactions, taken together, result in a large burden on the world's capital markets.

Substantive merger standards are also very important. If they are misspecified or misapplied, they can injure consumer welfare and harm economic growth. As matter of empirical observation, though, the vast majority of transactions presents no substantive competition concern in any jurisdiction; and for those transactions that do raise concern, only a handful will require detailed review or intervention by more than one or two jurisdictions. For even the largest and most active jurisdictions, the number of transactions that require close examination each year can be measured in the dozens. United States antitrust enforcers are largely pleased with the operation of our current test, "substantial lessening of competition." We have said, however, that the choice between that test and alternative tests is less important than having the same objectives, applying the same basic standards, and employing the same analytical framework. There is an emerging consensus among the major jurisdictions on a framework that focuses on consumer welfare and recognizes the benefits of efficiencies. When properly applied, all formulations of the substantive test should lead to essentially the same results in almost all cases. We would be pleased to address our experience with substantive merger standards in greater detail at a future conference.

CONCLUSION

We appreciate this invitation to return to Beijing to provide greater detail on our experience with merger control procedures. This is just one subset of the many complex issues that must be addressed in crafting a successful anti-monopoly law. We would welcome the opportunity to continue our fruitful discussions, so that China may make its policy judgments in light of the prior competition law experiences of the United States and other jurisdictions.